

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the 2016 Review of the)
Distribution Investment Rider Contained) **Case No. 17-38-EL-RDR**
in the Tariff of Ohio Power Company.)

In the Matter of the 2017 Review of the)
Distribution Investment Rider Contained) **Case No. 18-230-EL-RDR**
in the Tariff of Ohio Power Company.)

**INITIAL COMMENTS OF OHIO POWER COMPANY
IN RESPONSE TO 2016 AND 2017 DISTRIBUTION INVESTMENT RIDER
COMPLIANCE AUDIT REPORTS**

Pursuant to the Attorney Examiner’s August 30, 2018 Entry, Ohio Power Company (“AEP Ohio” or the “Company”) hereby files the following initial comments regarding the compliance audit reports that Blue Ridge Consulting Services, Inc. (“Blue Ridge”) filed on August 10, 2017 regarding Blue Ridge’s review of the Company’s Distribution Investment Rider (DIR) for the year 2016 (“2016 DIR Audit Report”), and August 23, 2018 regarding Blue Ridge’s review of the DIR for the year 2017 (“2017 DIR Audit Report”).

I. **Response to 2016 DIR Audit Report Recommendations**

A. Recommendation 1:

Blue Ridge recommends that work order costs associated with cost elements 141, 143, 145, 154, and 155 be removed from the DIR. These are costs that, in Blue Ridge’s opinion, are not payroll, payroll-related, or an appropriate overhead cost that benefits the project(s). (2016 DIR Audit Report at 22–23 and 51.)

Response:

The Company disagrees with this audit recommendation. These cost components represent a portion of the Company's actual cost of labor. The charges listed are part of the Company's competitive compensation plan and in totality make up the total compensation package. These cost components are components of the reasonable market competitive compensation provided to AEP employees that benefits customers by enabling the Company to attract, retain, and motivate the employees needed to efficiently and effectively provide electric service to its customers. AEP compares its compensation plans to market plans in order to maintain competitiveness as an employer. The particular cost components are included for short-term incentive compensation plans as well as long-term incentive compensation plans that allow employees at certain levels restricted stock and stock based compensation. The market based compensation includes base salary plus short-term incentive for the total cash compensation. Additional compensation packages include base salary plus short-term incentive for the total cash compensation and long-term incentive for the total compensation. In the development of the Staff reports prepared in the Company's last base rate case, the Staff specifically recognized this and incorporated incentives into their labor build up.¹ In the stipulation adopted in that case, the Staff reports were accepted as the basis of the Company's base distribution rates,² so removing these cost components would be inappropriate and create a disconnect in cost recovery between base rates labor and the labor incorporated in capitalized projects.

¹ Case No. 11-351-EL-AIR, *et al.*, Staff Report (Sept. 15, 2011).

² Case No. 11-351-EL-AIR, *et al.*, Opinion and Order (Dec. 14, 2011).

B. Recommendation 2:

Blue Ridge recommends that if the Distribution Business Rules for Authorizing Capital Projects is still in use in its current form, it should make mention within that document of the superseding status of the 2016 new Improvement Requisition Policy and Procedures. (2016 DIR Audit Report at 32.)

Response:

The Company no longer uses the Distribution Business Rules for Authorizing Capital Projects. Therefore, no further action is necessary with regard to this recommendation.

C. Recommendation 3:

Blue Ridge recommends that the Company highlight and quantify the capitalization change regarding the establishment of a retirement unit for Energy Control Devices and Displays and any other changes to the capitalization policy in the DIR filing preceding the implementation of the change. (2016 DIR Audit Report at 32, 40.)

Response:

The Company has been providing changes to the capitalization policy in the DIR filing. No additional changes are necessary.

D. Recommendation 4:

Blue Ridge recommends that the Company provide the reconciliation of the DIR account balances to the FERC Form 1 within the DIR filings, in compliance with the Commission's Opinion and Order in Case No. 13-2385-EL-SSO, *et al.* ("ESP III Order"). (2016 DIR Audit Report at 34 and 39)

Response:

The Company disagrees with Blue Ridge's position that the Company is out of compliance with the *ESP III* Order. The Company has worked with Commission Staff to verify that the Company is providing the information that Staff requires in the quarterly DIR filing.

Although the Company can implement this audit recommendation, neither the Commission nor PUCO Staff has advised the Company that this additional information is necessary. As such, the Company has not changed its quarterly filings. In addition, the Company has always reconciled the DIR account balances to the FERC Form 1 during the preparation of the quarterly DIR filing. When the Company finds a discrepancy between the two, the Company follows up with AEP's Property Accounting group to fix the discrepancy and uses correct DIR account balances at the time of the quarterly DIR filing.

E. Recommendation 5:

Blue Ridge recommends that the Company follow through with the error discovered regarding the retirements for work order 42263333 and reclassify the associated \$145,000 to the proper work order. (2016 DIR Audit Report at 36)

Response:

The correction was made in 2017. No further action is required.

F. Recommendation 6:

Blue Ridge recommends that the vegetation management schedule in the DIR include the plant accounts and subaccounts. (2016 DIR Audit Report at 38.)

Response:

The Company has fulfilled this request. The only FERC account to record capitalized vegetation management activity is account 365, which has no subaccounts.

G. Recommendation 7:

Blue Ridge recommends the issue of the Company's inclusion of capital spares in the DIR be given further review. The Company should look into borrowing capital spares, if it makes economic sense, or, at a minimum, perform an analysis to compare renting versus the purchase of a capital asset. (2016 DIR Audit Report at 48.)

Response:

The Company disagrees with this audit recommendation. It does not make economic sense to borrow capital spares from third party entities. A capital spare is used primarily as a permanent replacement for a failed station transformer. The Company has capital spare transformers to facilitate the replacement of a failed unit in a timely manner. The Company holds economic quantities of transformer spares based on the number of units in service, historical transformer failure rates, and affiliate transfers amongst AEP companies.

Renting a mobile transformer will cost approximately \$75 thousand per month. It will cost about \$750 thousand to rent a temporary transformer if the lead time to install a new transformer is ten months. If the Company owns a spare transformer and replaces a failed one with it, it would save \$750 thousand over renting one because it needs a permanent replacement for a failed station transformer.

In addition, the following items should be considered. First, if the Company rents to own, it likely would be receiving an asset without the manufacturer's warranty. Transformers have a tendency to fail either early in use or at the end of its life. Second, if the Company rents to temporarily fill its need while waiting for a purchase, it would incur double the installation and demolition costs. This is typically several days of work for a crew (128 hours labor demo + 128 hours labor assemble/commission), could require a mobile installation (~\$6k per install average),

and two outages to customers. Lastly, the unique configurations of many AEP-owned transformers are specific to its facilities. The likelihood of finding a perfect match to its station configurations and necessary ratings at an outside vendor are unlikely in many scenarios. This means entire stations could require being rebuilt to install rental transformers. As such, it is more economic to own spare capitals than renting the capital assets.

H. Recommendation 8:

Blue Ridge recommends that the Company, in order to complete the project justification, document all alternatives (operational and/or economic), providing the reason(s) one alternative is better than another and, if savings are estimated, indicate how those savings are to be realized. If no alternatives were considered, document the reason(s) as well. (2016 DIR Audit Report at 48–49.)

Response:

The Company disagrees with this audit recommendation. During Capital Program Approval Requisition process, the Company is required to document alternatives and reasons for selection of the chosen alternatives. The Company is already implementing the project justification requirements and providing adequate information for business decisions.

I. Recommendation 9:

Blue Ridge recommends that the Company continue to manage to the budget and document reasons for overage or underage of actual charges whether those reasons are outside or within the direct control of the Company in order to demonstrate that the budget variance did not result from lack of budget management control. (2016 DIR Audit Report at 50.)

Response:

The Company disagrees with this audit recommendation. Typically, the budget is established six months in advance of the budget year. Without the funding approval, no projects can be commenced. As a result, the initial project scope and estimates provide a high level framework and do not include various unexpected items, but will in many cases include a funding contingency that addresses a reasonable percentage of unknowns. Upon funding approval, the Company reviews a monthly project monitoring report, which shows budget-to-actual variances. When the Company determines that the projected cost will exceed the budget amount by 120%, it is required to revise the Capital Program Approval Requisition, document the reason for the revision and obtain the required senior management approvals.

J. Recommendation 10:

Blue Ridge recommends that when large projects are developed, the Company place greater emphasis on ensuring the work plan is complete and that the contractors performing the work understand the requirements from both work and safety perspectives. (2016 DIR Audit Report at 51.)

Response:

The Company disagrees with this audit recommendation. The Company takes safety very seriously and has already implemented its Contractor Oversight Program to make sure the contractors understand the work requirements and job safety. The program is composed of Onboarding, Jobsite Observation, and Performance Data. The Onboarding process ensures the Company to screen and hire qualified contractors. The Jobsite Observation is conducted once a week to inspect contractors' safety, performance and billing records. The Company reviews monthly Performance Data, including DART rate target, Standard Build and work order cost

information. Negative trend reports, and incidents and injuries can result in disciplinary actions including a discussion and follow up with contractor management or further discipline up to and including termination of the contract. The Company's action to remove the contractors shows that it is placing a great emphasis on ensuring the work plan is complete and that the contractors performing the work understand the requirements from both work and safety perspectives.

K. Recommendation 11:

Blue Ridge recommends the Company continue to monitor inactive work orders that appear on the report, striving to resolve outstanding issues within a reasonable time frame of six months to reduce the total dollar value of inactive work orders. (This recommendation appeared in last year's report. Blue Ridge agrees with the Company that work orders may remain inactive for reasons outside the Company's control, and we acknowledge the Company's statement that monitoring is conducted on the inactive work order report. However, because of the significant duration of some of the inactive work orders, by this recommendation, Blue Ridge is continuing to stress the importance of focus to ensure that outstanding issues able to be resolved are resolved). (2016 DIR Audit Report at 52–53.)

Response:

The Company agrees with this recommendation and actively tracks and addresses inactive work orders.

L. Recommendation 12:

Blue Ridge recommends that the Company correct the Standard Fringe Factor that included the non-productive time rate twice. The impact was an overstatement of the fringe benefit loading rate by approximately 15 percent. As this rate is used for the capitalization of meter and line transformer installations and removal costs, its overstatement results in an

overstatement in these capital amounts. The Company is developing an analysis of the impact and will provide it later. Blue Ridge recommends that the Company calculate the impact of the overstatement, and adjust the DIR. (2016 DIR Audit Report at 55.)

Response:

The Company has corrected the fringe factor as suggested in this recommendation.

II. Response to 2017 DIR Audit Report Recommendations

A. Recommendation 1:

Blue Ridge recommends that the Company, in its vegetation management policy, better define capital and expense work associated with clearing of Rights of Way so as to be in accordance with the FERC Code of Accounts for those activities. Specifically, any vegetation management activity on an existing right of way, other than what may come about because of storm restoration, should be considered expense. (2017 DIR Audit Report at 34.)

Response:

In the Electric Plant Instructions, the FERC Uniform System of Accounts (USofA) states that the initial clearing of land and rights-of-way are to be charged to appropriate plant capital accounts. All subsequent costs are to be charged to maintenance. AEP accounting policy complies with these instructions.

Costs of removing trees greater than 18” in diameter from the right-of-way after the line is in operation represents an “initial” clearing because that portion of the right-of-way was not previously cleared and is therefore properly capitalized under the AEP accounting policy and FERC USofA. Although it is impossible to determine if an existing tree within the right-of-way was trimmed in the original clearing of a line, AEP’s accounting policy developed a proxy to determine if a tree was originally cleared. That proxy is an 18-inch diameter tree. If the tree’s

diameter is equal or greater than 18 inches, then it is considered not to have been cut during the original clearing, and would thus be capitalized. If the diameter is less than 18 inches, it is considered to have been cut during the original clearing and would be charged to maintenance expense.

Specifying a diameter for use in determining Capital or Expense is a method to distinguish between “original” trees and those that have grown since a power line was constructed. An 18” diameter will encompass many trees that are approximately 22 years or older. In practice, the company is not able to remove all the trees it would like to remove. Often, customers will not grant permission to remove trees on private property even though those trees are in danger of falling on company lines or equipment or growing into the lines. In addition, areas with certain clearance (such as valleys) are not cleared during initial construction of line. For example, there have been areas where the line crosses a valley and at the time of construction, the trees were small and an engineer or right-of-way agent decided the removal of trees was not cost saving. As the trees continue to grow, they could reach a height that the Company believes should selectively be removed.

In addition, and in compliance with USofA, there are long-term benefits to the distribution system that are recognized with tree removal. If there is vegetation that is removed rather than just trimmed, it would take years for the tree to grow back. However, certain other types of maintenance recognizes that the growth will need to be “maintained” at some cycle level. Capital removal provides long-term benefits as once the tree is gone, there is no longer a threat to outage and property. Capitalized assets reflect long-term system improvement, and the system is certainly improved when the threat is permanently removed.

B. Recommendation 2:

Blue Ridge recommends, as it did in the Compliance Audit report of the 2016 DIR, that the Company comply with the Commission’s Order by including the reconciliation of the DIR account balances to the FERC Form 1 within the DIR filing. Specifically, in its *ESP III* Order, the Commission stated: “We further modify the DIR to adopt the six recommendations by Staff regarding detailed account information” and the “reconciliation between functional ledgers and FERC form filings.” (2017 DIR Audit Report at 35, 40–41.)

Response:

The Company has not implemented the recommendations from the Blue Ridge 2016 audit report because the Commission has not issued an order on those recommendations. The Company disagrees with Blue Ridge's position that the Company is out of compliance with the *ESP III* Order. The Company disagrees with this audit recommendation. See the Company’s response to Blue Ridge’s 2016 DIR Audit Report Recommendation 4, *supra*.

C. Recommendation 3:

Blue Ridge recommends that the Commission consider the capital status of cost element 148 along with the other incentive-associated cost elements in the next base distribution case. In the DIR audit report in Docket 17-0038-EL-RDR, Blue Ridge recommended that certain cost elements associated with incentive compensation be removed from the DIR report. In considering Blue Ridge’s recommendation, the Commission approved the stipulation that this issue would be better addressed as part of the base distribution case to be filed by June 2020. (2017 DIR Audit Report at 50.)

Response:

The Company disagrees with this audit recommendation. See the Company's response to Blue Ridge's 2016 DIR Audit Report Recommendation 1, *supra*.

D. Recommendation 4:

Blue Ridge recommends that large projects be more closely scoped out in the field to try to mitigate potential impediments that could increase the project estimate or increase the schedule, delaying the project completion. (2017 DIR Audit Report at 56.)

Response:

The Company disagrees with this audit recommendation. The Company considers the cost, benefit, and risk of decisions for each project. In order to implement Blue Ridge's recommendation, the Company would have to spend additional time and money on every project. This would not only increase the amounts customers would have to pay for the same system but also delay the amount of work the Company could complete in any year. Blue Ridge's recommendation would essentially increase the cost of all projects in order to avoid very few projects that may have small cost overages from potential impediments. This recommendation would increase costs to customers with no commensurate benefits.

E. Recommendation 5:

Blue Ridge recommends that the next DIR audit review the compliance of that filing with the Commission's final decision in the Company's requested AEP Ohio-specific tax reform docket (Case No. 18-1007-EL-UNC) to facilitate the Company's implementation of the TCJA. (2017 DIR Audit Report at 65.)

Response:

The Company agrees with this recommendation.

CONCLUSION

Consistent with the above explanations, AEP Ohio requests that the Commission reject and accept Blue Ridge's recommendations to the extent set forth in these comments.

Respectfully submitted,

/s/ Steven T. Nourse

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CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing was sent by, or on behalf of, the undersigned counsel to the following individuals this 26th day of October, 2018, via electronic transmission.

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Summary: Comments - Initial Comments of Ohio Power Company in Response to 2016 and 2017 Distribution Investment Rider Compliance Audit Reports electronically filed by Mr. Steven T Nourse on behalf of Ohio Power Company